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UNCLAS SECTION 01 OF 02 KUALA LUMPUR 001641

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STATE PASS USTR - WEISEL AND JENSEN
STATE PASS FEDERAL RESERVE AND EXIMBANK
STATE PASS FEDERAL RESERVE SAN FRANCISCO TCURRAN
SINGAPORE PASS TO SBAKER
USDOC FOR 4430/MAC/EAP/J.BAKER
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SUBJECT: MALAYSIA CONCERNED ABOUT FOREIGN DIRECT INVESTMENT TRENDS

11. (U) Summary: Malaysia's foreign direct investment flows rose rapidly in 2006, according to the UN Conference on Trade and Development (UNCTAD) World Investment Report 2007. However, while a 52.8% increase in inward FDI flows reversed a declining trend over the past five years, the bigger news was that FDI outflows rose by over 100 percent. Following this very rapid rise in 2006 FDI outflows, Malaysia's inward and outward FDI flows were roughly in balance at about USD 6 billion each. If this trend continues, Malaysia will be facing net FDI outflows going forward. Not surprisingly, while the GOM publicly cites Malaysian FDI abroad as proof of success, it privately is carrying out a number of studies to see what can be done to improve Malaysia's ability to attract FDI. If Malaysia is already experiencing capital flight as some private sector analysts argue, the GOM's efforts to address the problem could be a catalyst for reform.

THE GOVERNMENT'S VISION FOR THE ECONOMY

12. (U) As a destination for FDI, Malaysia's attractiveness is narrowing as the country becomes less competitive for lower-wage manufacturing. In response, the GOM is seeking to move the economy "up the value chain" by promoting specific sectors. In its 2006-2020 Third Industrial Master Plan, the GOM identified specific higher-tech industries it wanted to attract and develop. In the manufacturing sector, these include electrical & electronics; medical devices; textiles & apparel; machinery & equipment; metals; and transportation equipment. Investors in targeted industries often can negotiate favorable terms with the GOM; investors in non-targeted industries tend to face more bureaucratic obstacles. Also targeted for growth were a number of resource-based industries and some services sub-sectors; however, the extent to which foreign investors are allowed to participate in these sectors is limited.

FDI INFLOWS REBOUND IN 2006

13. (U) In October, the UN Conference on Trade and Development (UNCTAD) reported that FDI to Malaysia increased by 52.8% after a 14.5% decrease in 2005. Inflows during 2006 restored total inward FDI stock to 1.6% above its 2000 level after having dropped off measurably by 2005. Malaysia retained its 2005 global rank of 62nd largest destination for FDI, keeping apace with a sharp global increase, but nowhere close to its status a decade ago when it ranked sixth in 1995.

OUTFLOWS DOUBLE: BUSINESS ACUMEN OR CAPITAL FLIGHT?

14. (U) Outward flows of FDI more than doubled in 2006 TO USD 6.04 billion -- nearly equal to Malaysia's inward flows of USD 6.06 billion. The Prime Minister claims that this is a testament to the competitiveness of Malaysian businesses as they expand operations throughout the region. In fact, the GOM encourages companies to go offshore and has directed some of its state-owned companies to do so. Telekom Malaysia purchased businesses in India, Sri Lanka, Indonesia and Cambodia. CIMB, a Malaysian bank, is purchasing offshore banks throughout the region. Petronas is expanding rapidly across the globe as Malaysia's oil reserves begin to taper off.

GOM COMMISSIONS STUDIES

15. (U) While the Government publicly claims the outflows as a success story, behind the scenes they are looking into the matter more closely. Earlier this year, the GOM commissioned the Economic Research arm of Rating Agency of Malaysia (RAM) to conduct the study, "The Changes and Determinants of Foreign Direct Investment in Malaysia." The Study included industry feedback and recommendations for improving the business climate.

16. (U) In addition, the Economic Planning Unit (EPU), which reports to the Prime Minister, is actively soliciting feedback from the business community on what the GOM needs to do to attract foreign direct investment and promote a vibrant business sector. On November 15 the EPU sent letters to businesses explaining that they had hired an independent consultant to conduct a market audit that would examine current perceptions of Malaysia as a destination for business and investment. The letter requested input and feedback in a confidential one-on-one interview on the advantages and disadvantages of doing business in Malaysia, its livability, and recommendations for enhancing Malaysia's business competitiveness.

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17. (U) Private sector analysts take a decidedly less enthusiastic view of the surge in outward flows. They attribute a significant amount of it to the capital flight of disillusioned ethnic minorities who feel they are gradually being squeezed out by Malaysia's racial preference policies and to the frustration of businesses looking for less restricted markets.

COMMENT

18. (U) Comment: The Prime Minister has been pushing state-owned entities to expand overseas in an effort to force them to become more competitive, even while he maintains the racial preference policies that have made them reluctant to move offshore. At the same time, capital flight as a factor driving the rapid rise in FDI outflows cannot be denied. If Malaysia begins to experience significant net FDI outflow in the coming years, it could be a driver for greater domestic economic reform.

KEITH